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TAGS: [EPET](#) [EINV](#) [ENRG](#) [ECON](#) [PREL](#) [EC](#)
SUBJECT: CANADIAN-US COMPANY PURSUING MAJOR PETROLEUM
INVESTMENT IN ECUADOR

REF: QUITO 2277

Classified By: Jefferson Brown, Reasons 1.4 (b&d)

¶1. (C) Summary: Ivanhoe Energy, a Canadian firm with substantial U.S. investment, is pursuing oilfield development in Ecuador that would use its proprietary technology to develop and upgrade super-heavy oil. President Correa is reportedly supportive and wants to move quickly to sign a contract as early as January 2008. On December 6, Ivanhoe presented a contract proposal to the head of Ecuador's state oil company, who agreed to start negotiations based on the proposal. End Summary.

¶2. (U) Ivanhoe Energy is a Canadian-registered company with major U.S. investment. David Martin, the Executive Co-Chairman, is a former President and CEO of Occidental Petroleum, and a geologist with 40 years experience in the oil and gas industry. Ivanhoe is a small oil producer with operations principally in the U.S., Canada, and China, but most significantly has invested in a new technology that converts very heavy crude petroleum into a lighter product with lower viscosity that is easier to transport and refine. It completed a pilot project in California to prove the technology and is now looking for opportunities to utilize it, most recently in Ecuador.

Ivanhoe Representatives Meet With President Correa

¶3. (C) On October 18, senior representatives of Ivanhoe Energy held meetings with President Correa and the board of state oil company Petroecuador on potential heavy oilfield development in Ecuador. They then met with Embassy officials to brief us on the meetings and request our views on the potential project. The Pungarayacu field (near Tena in the Oriente region) has remained unexploited for many years due to the heaviness of the oil (reportedly tarsands so heavy they are solid). Ivanhoe Director Steve Rhodes claimed the firm's proprietary "heavy to light" (HTL) crude upgrading technology would allow the field to be developed. He reported that Correa was very enthusiastic and was sending a ministerial level group to Ivanhoe's Bakersfield, California facility two days later to see the technology, report on it, and discuss a potential contract. Rhodes claimed the project would be a 30 year, USD 6 billion contract, with an initial investment of USD 2.5 billion in the first few years. Of particular interest to Correa, Rhodes noted, was the fact that the operation could be up and running in 3 years.

¶4. (C) On December 7, representatives of Ivanhoe met again with Embassy officials to update us on their progress. Executive Co-Chairman David Martin reported that Ivanhoe submitted a proposal to Petroecuador at the state oil company's request, and that its new chief Guillermo Zurita signed a letter December 6 agreeing to start contract negotiations along the lines of the proposal. The GOE wants to move very quickly, Martin said, and would reportedly like to have an agreement signed by January 1, 2008 (although he conceded that it would probably take until February). In addition to developing and upgrading the Pungarayacu heavy crude, Ivanhoe would explore putting a small upgrading plant next to the aging Esmeraldas refinery. Martin also commented that Petroecuador had asked for technical assistance in reviewing all of their refineries for potential upgrades.

Ivanhoe's Proposal

¶5. (C) According to Martin, Ivanhoe's proposal is a hybrid of a production sharing contract (where companies benefit if oil prices rise but bear the risk if prices fall) and a service contract (where firms are paid a fixed fee for their services). (Note: currently, almost all petroleum contracts in Ecuador are production sharing contracts, but the GOE has expressed a desire to move to service contracts, and is attempting to renegotiate contracts with oil companies to make this change.) Martin said their contract includes cost recovery (like a production sharing contract), including capital and operating costs. Ivanhoe would potentially be able to book petroleum reserves through this. It also includes a service fee of a fixed amount per barrel of oil adjusted for international inflation.

Comment:

¶6. (C) In the December 7 meeting with Embassy officials, Martin and his associates were very positive, confident, and forward leaning about their potential contract with the GOE. Surprisingly, they did not appear concerned about possible contract problems, in spite of recent changes to petroleum revenue-sharing arrangements by the GOE that many firms see as unilateral contract changes (reftel). Embassy officials highlighted the many contract issues facing petroleum companies operating in Ecuador. Martin responded that "everything would be built into the contract" and noted his extensive global experience in the sector. He also commented that other countries outside the U.S. "don't see Ecuador as risky," and that he expects to easily obtain investment funds from an international consortium of oil and investment banking interests. He further noted that the investment consortium might include some national oil companies (firms he implied President Correa would see as natural allies and not want to alienate).

¶7. (C) However, Martin noted that the issue of arbitration could be a sticking point in negotiations. The GOE has recently emphasized that it will only provide for local arbitration in any future petroleum contracts. Previously, Ivanhoe representatives had mentioned that the lack of international arbitration provisions in their contract would probably not be an issue. However, this time Martin mentioned that if London and New York investors were involved, international arbitration provisions could be a requirement. It will be interesting to see how the GOE balances its recent statements on arbitration with the need for investment. Nevertheless, a large, successful U.S. investment in Ecuador, if realized, would be an excellent development.

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